FILED
DEC 28 1956
JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 662

RALPH C. PRICE, *Petitioner*

v.

THE UNITED STATES, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

STANLEY WORTH
EDWARD S. SMITH
404 Transportation Building
Washington 6, D. C.

D. NEWTON FARNELL, JR.
Jefferson Standard Building
Greensboro, North Carolina
Counsel for Petitioner

Of Counsel:

BLAIR, KORNER, DOYLE & WORTH

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

TABLE OF CONTENTS

	Page
Opinion Below	1
Jurisdiction	2
Questions Presented	2
Statute Involved	3
Statement of the Case	3
Reasons for Granting the Writ	
I. The decision below is in direct conflict with the established law relating to taxation of partnership income, the only issue involved, and is otherwise arbitrary	8
II. The decision below is arbitrary since it is unsupported by, and is repugnant to, the Findings of Fact	12
III. The lower Court's primary conclusion begs the question in vague language and by specious reasoning	15
IV. The lower Court's further conclusion that petitioner assigned his income to his wife is wholly unsupported in fact or in law	18
V. The termination clause in the lease had no legal effect on the issue	20
Conclusion	22
Appendix	1a-29a

CITATIONS

CASES:

Culbertson, Commissioner v., 337 U.S. 733	9, 10, 11, 14, 17, 19, 22
Eubank, Helvering v., 311 U.S. 122	19
Harrison v. *Schaffer*, 312 U.S. 579	19
Horst, Helvering v., 311 U.S. 112	19
Ingle Coal Corp. v. *U. S.*, 141 C. Cls. 121, cert. den. 350 U.S. 842	18
Lusthaus v. *Commissioner*, 327 U.S. 293	9
Scofield v. *Mauritz* (CA-5) 206 F. 2d 135, 140	11
Sunnen, Commissioner v., 333 U.S. 591	19, 21
Tower, Commissioner v., 327 U.S. 280	9
West v. *Commissioner* (CA-5), 214 F.2d 300, 302	11

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner, Ralph C. Price, prays that a writ of certiorari be issued to review the decision of the United States Court of Claims in the above case.

OPINION BELOW

The findings of fact and opinion of the United States Court of Claims are reported at 142 F. Supp. 455. A copy thereof is included in the Appendix (pp. 3a-29a).

JURISDICTION

The decision of the United States Court of Claims[1] was entered July 12, 1956 (App. p. 3a). On August 8, 1956, the petitioner filed a motion for rehearing which was overruled by the court below on October 2, 1956 (R. 58). Jurisdiction of this Court is invoked under 28 U.S.C. § 1255(1), 62 Stat. 928.

QUESTIONS PRESENTED

1. Where three unrelated individuals, one of whom is petitioner's wife, specifically intended to and did form a partnership to operate a hotel under a lease from the corporate owner, and such partnership did so operate for a period of more than five years (including the years in controversy), when each partner sold his or her partnership interest to other parties; and where during such period petitioner's wife actively participated in partnership affairs, and where the petitioner never intended to and never did become a partner and never participated in the affairs of said partnership; was the Court below in error in holding that the Commissioner of Internal Revenue properly taxed to the petitioner his wife's distributive share of partnership income for each of the years involved?

2. Having found and held that the rent paid by the partnership to the corporate owner under the lease was not unfair or unreasonable; that the Commissioner accepted as correct for each year the net income reported by the partnership, and the distributive shares of each partner; that the Government's argument that "the whole transaction" was a tax sham "is without significance"; and in the absence of a finding that the petitioner was a partner, and that his wife was not;

[1] Judges Whitaker and Littleton dissenting.

was there any legal warrant for the lower Court's holding "that the transaction insofar as [petitioner] was concerned lacked substance and was a tax sham?"

3. Since the lease was fully operative during all years in controversy, and has been recognized by the Commissioner and by the lower Court as valid for the purpose of determining net income of the partnership and the distributive shares of the partners, does the termination clause in the lease have any legal significance in the instant case?

4. Is there any legal basis for the lower Court's further holding that the taxes are sustainable "on the ground that [petitioner] anticipatorily assigned his right to a portion of the income from the hotel?"

STATUTE INVOLVED

The pertinent provisions of the Internal Revenue Code of 1939 (26 U.S.C.A. 1944 Edition) relating to partnerships are set forth in the Appendix (pp. 1a-3a).

STATEMENT OF THE CASE

This is a suit for refund of Federal income taxes for the calendar years 1945, 1946 and 1947 which was timely filed in the United States Court of Claims under Title 28, Section 1491 of the United States Code, following the rejection of claims for refund by the Commissioner of Internal Revenue. (R. 1).

Cotton States Hotel, a North Carolina corporation owned and operated the King Cotton Hotel in Greensboro, North Carolina, commencing during the 1930's. In May 1937, Mr. Haywood Duke was employed as Manager of the hotel and Mr. Harold Colvert was employed as Assistant Manager (Fdg. 5, App. p. 12a). In 1943, said corporation had gross profits of approxi-

mately $179,000 and net income of approximately $88,000, and Mr. Duke's compensation, based on a fixed salary plus a percentage of the profits, was approximately $21,000 (Fdg. 6, App. p. 13a).

Prior to February 1, 1944, Mr. Duke acquired 47 shares of common voting stock out of a total 100 shares outstanding, and the petitioner owned 51 shares of said common stock (Fdg. 7, App. p. 13a). Said corporation also had outstanding $125,000 in preferred (non-voting) stock (Fdg. 6(b), App. p. 13a).

After his stock purchase and prior to February 1, 1944, Mr. Duke sought the opinion of the corporation's auditor (who was tax consultant for the corporation and for Mr. Duke personally), as to the feasibility of transferring the operation of the hotel business from the corporation to a partnership composed of stockholders in order to eliminate excess profits tax liability to the corporation. He was advised that it would be better if one member of the partnership was not a stockholder in the corporation. Mr. Duke's partnership proposal was discussed at a conference with the petitioner, petitioner's father, and an attorney. Petitioner's wife was not present at that meeting but the proposal was later discussed with her by the petitioner, petitioner's father, and Mr. Duke (Fdg. 8, App. p. 14a).

On February 1, 1944, Haywood Duke, Martha Garner Price (petitioner's wife) and Harold Colvert signed an agreement forming a partnership under the firm name of King Cotton Hotel. The petitioner was not present (Fdg. 9(a), App. p. 14a).

Also on February 1, 1944, Cotton States Hotel Company leased its hotel, complete with all furnishings,

fixtures, equipment and inventories to the said partnership for a term of 20 years at a monthly rental of $5,000. The lease contained the following clause:

> It is understood and agreed that inasmuch as the Lessees are not required to post a good and sufficient bond guaranteeing full performance on the part of said Lessees, the Lessor, at its option, may, with or without cause, and in its absolute discretion, terminate this lease at any time upon giving sixty (60) days' written notice to the Lessees. (Fdg. 9(b), (c). App. p. 15a).

Under said partnership agreement the capital contributions of the partners, also the division of profits and the sharing of losses were in the following ratios: Haywood Duke, 47½%, Martha Garner Price 47½%, Harold Colvert, 5%. (Fdg. 10, App. p. 17a).

Also under said partnership agreement Mr. Duke was to devote his entire time and attention as General Manager of the business and was to receive a monthly salary of $500. Mr. Colvert was to devote his entire time and attention as Assistant Manager and to receive a monthly salary of $250. All matters of importance were to be approved by all the partners (Fdg. 10, App. p. 16a). The latter provision was fully observed. (Fdg. 12, App. p. 18a).

Each of the partners made his capital contributions, and operation of the hotel by the partnership was begun February 1, 1944. Such operations under the terms of the partnership agreement and under the lease from the corporate owner were continued until June 1, 1949. (Fdg. 11, App. p. 17a).

Although the partnership agreement did not prescribe any duties for Mrs. Price, she actively partici-

pated in advancing the business of the hotel, and rendered valuable services with respect to the furnishings and interior decorations. (Fdg. 12, App. p. 17a).

The partnership filed with the Commissioner of Internal Revenue its partnership information returns for its fiscal years ended January 31, 1945, 1946 and 1947, which showed its net income and the distributive shares of each partner (including salaries to Messrs. Duke and Colvert), as follows:

Partner	1945	1946	1947
Mr. Duke	$ 66,055.42	$ 83,532.14	$ 85,676.36
Mr. Colvert	9,446.62	11,161.27	11,386.99
Mrs. Price	60,055.42	77,532.44	79,676.36
Total	$135,557.46	$172,225.55	$176,739.71

(Fdg. 13, App. p. 18a).

As President of Cotton States Hotel Company during the years involved, the petitioner drew a nominal salary of $2,500 (Footnote 2 to Fdg. 9(b), App. p. 15a). Petitioner's principal employment was as Executive Vice-President of Jefferson Standard Life Insurance Company until January 1946, when he succeeded his father (Mr. Julian Price) as President at the time his father became Chairman of the Board (Fdg. 2, App. p. 11a).

The petitioner never intended to be a partner in the King Cotton Hotel partnership and never participated in its affairs (Fdg. 30(b), App. p. 28a).

An Internal Revenue agent made an examination of the separate income tax returns filed by the petitioner and his wife for the calendar years 1945, 1946 and 1947, also examined the partnership returns of

King Cotton Hotel for its fiscal years ended January 31, 1945, 1946, and 1947 (Fdg. 17, App. p. 20a).

On May 9, 1949, by so-called 30-day letters the Internal Revenue Agent in Charge transmitted to the petitioner, to Mrs. Price, and to the King Cotton Hotel partnership, copies of the reports made by the revenue agent dated January 20, 1949, which proposed deficiencies to the petitioner and refunds to Mrs. Price based upon taxing to the petitioner, instead of to Mrs. Price, her distributive share of the net income in the King Cotton Hotel partnership for the fiscal years 1945, 1946 and 1947 (Fdg. 20, App. p. 22a). The said reports include the following statements:

> The validity of Mr. Duke and Mr. Colvert as partners is not questioned. * * * Inasmuch as the control of the lease, which is vested in Mr. R. C. Price, controlling stockholder of the lessor corporation, is the sole income producing factor to the partnership, it is held herein that Mr. Price rather than his wife, Mrs. Martha Garner Price, is a partner.

The partnership net income as reported was accepted as correct. (Fdg. 21(a), App. p. 23a).

In May 1949, the Alsonett hotel interests purchased the stock of Cotton States Hotel Company. At the same time the separate partnership interests in the King Cotton Hotel partnership were purchased from the partners, Mrs. Price's partnership interest being purchased for $100,000. Prior to such purchase, and at the instance of Alsonett, the lease between Cotton States Hotel Company and the partnership was amended to eliminate the termination clause, increase the rent, and reduce the term. The King Cotton Hotel

partnership was formally dissolved July 15, 1952 (Fdg. 22, App. p. 24a).

On July 26, 1949, the Commissioner mailed to petitioner a deficiency notice setting forth his final determination of deficiencies in income tax for the years 1945, 1946 and 1947, aggregating $175,098.60, based upon taxing the petitioner on Mrs. Price's share of partnership income. Said deficiencies, together with interest aggregating $24,307.33, were assessed Sept. 30, 1949 and were paid by petitioner in October, 1949 (Fdg. 24, App. p. 24a).

On November 18, 1949, the Commissioner refunded to Mrs. Price the tax which she had paid on her distributive share of partnership income for said years (said tax amounting to $122,472.91), together with interest of $19,339.12 (Fdg. 25, App. p. 25a). The petitioner filed timely claims for refund for 1945, 1946 and 1947 on July 27, 1951, which were rejected May 16, 1952 (Fdg. 26, App. p. 25a). The petitioner timely filed his petition in the Court of Claims November 2, 1953, and the Third Party Complaint was filed by the United States against Mrs. Price August 19, 1955 (Fdg. 27, App. p. 25a).

REASONS FOR GRANTING THE WRIT

I. The decision below is in direct conflict with the established law relating to taxation of partnership income, the only issue involved, and is otherwise arbitrary

As stated at the beginning of the opinion below "The sole issue is whether part of the income of the King Cotton Hotel partnership should be taxed to plaintiff, as the defendant contends, or to the plaintiff's wife, as the plaintiff contends" (App. p. 3a). That being the issue, it should have been squarely met and decided under the law and on the facts.

In January, 1949, when the revenue agent completed his examination of the returns of the King Cotton partnership, the petitioner, and his wife, Martha Garner Price, the controlling decisions concerning the taxation of partnership income were *Commissioner* v. *Tower*, 327 U.S. 280, and *Lusthaus* v. *Commissioner*, 327 U.S. 293. Failure to correctly interpret and apply the principles of those cases resulted in conflict in the lower courts as was recognized by this Court in *Commissioner* v. *Culbertson*, 337 U.S. 733. The *Culbertson* opinion and the concurring opinions therein so clearly defined and clarified the law and the applicable principles as to remove any lingering doubt. The true test is:

> * * * whether, considering all the facts—the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent—the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise.[2]

And "their intention in this respect is a question of fact".[3]

Had the Court of Claims correctly applied those principles in the case at bar to the facts found by it,[4] inevitably it must have concluded that the petitioner's wife Martha Garner Price was a partner in the King

[2] 337 U.S. at pp. 742-743.

[3] 337 U.S. at p. 741.

[4] See Reason II, *infra*, p. 12.

Cotton Hotel partnership, and that the petitioner was not. Instead, it carefully avoided either a finding or a holding that the petitioner was a partner; indeed the opinion clearly implies that he was not in stating "Mrs. Price received substantially the same income that plaintiff would have received *had he been the partner*" (Emphasis supplied.) (App. p. 10a).

As stated in the *Culbertson* opinion (337 U.S. at pp. 739-740), "To hold that 'Individuals carrying on business in partnership'[5] include persons who contribute nothing during the tax period would violate the first principle of income taxation: that income must be taxed to him who earns it." Such a violation occurred here. The petitioner never intended to become a partner and never did, he did not sign the partnership agreement, made no capital contribution to the partnership, never rendered any services to nor participated in partnership affairs, never received any distribution of income or capital from the partnership, and (when Mrs. Price sold her partnership interest after more than five years of partnership operation) petitioner was not a party to that transaction. On the affirmative side, all of these tests were met by Mrs. Price.

Nor can the principles of the *Culbertson* case be obscured, nor the controlling effect thereof diminished, by resort to vague language or clouded reasoning.[6]

The lower Court's statement of the "sole issue" involved required a specific finding and holding as to which one, the petitioner or his wife, was the third partner in the King Cotton Hotel partnership. On

[5] Sec. 181, I.R.C. 1939, App. p. 1a.

[6] See Reasons III and IV, *infra*, pp. 15, 18.

no other basis, consistent with the *Culbertson* principles, could it be determined "whether part of the income[7] of the King Cotton Hotel partnership should be taxed to plaintiff, as the defendant contends, or to the plaintiff's wife, as the plaintiff contends" (Op. first paragraph, App. p. 3a).

The lower Court's statement of the issue before it clearly brings the case at bar within the ambit of the *Culbertson* rule. As will be shown under Reason II, *infra*, the facts found by the Court of Claims inescapably lead to the conclusion that the petitioner was not a partner and, therefore, was not taxable on the distributive share of partnership income of his wife who was a partner. A contrary holding would be repugnant to the *Culbertson* principles which, of itself, would warrant the intervention of this Court. The lower court's failure directly to decide the partnership issue, the only issue before it, was contrary to established judicial procedure. The reasons stated in the majority opinion as the grounds for its decision[8] are foreign to the issue which was before the lower Court, hence the decision is at variance with the issue and was arbitrary. Cf. *West* v. *Commissioner* (CA-5) 214 F. 2d 300, 302; *Scofield* v. *Mauritz* (CA-5) 206 F. 2d 135, 140. Uniformity and justice call for the exercise by this Court of its power of supervision under such circumstances.

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[7] Namely, the part distributable to Mrs. Price under the partnership agreement.

[8] Quite apart from their frailties which are discussed, *infra*, pp. 15-20.

II. The decision below is arbitrary since it is unsupported by, and is repugnant to, the findings of fact

The findings of fact of the Court below are identical with those recommended by the report of its Commissioner (R. 19), even as to footnotes. So far as the facts are material to the partnership issue, the only issue before it, the Court of Claims found:

That under the management of Haywood Duke, who had been employed since May 1937, the King Cotton Hotel, owned and operated by Cotton States Hotel Co., a North Carolina corporation, in 1943 enjoyed its most prosperous year to that time. Mr. Duke's assistant during that period was Harold Colvert (Fdgs. 5, 6, App. pp. 12a, 13a). In June 1943 Mr. Duke proposed to the stockholders of the corporation that the corporation lease the hotel to a partnership to be composed of the petitioner and Mr. Duke. At that time petitioner owned 15 shares (51%) of the voting common stock, the remaining common being held by outside interests. There was also $125,000 in preferred (nonvoting) stock outstanding. The proposal was rejected by the stockholders (Fdg. 6, 28(a), footnote 13, App. pp. 13a, 26a).

Shortly before February 1, 1944, Mr. Duke purchased 47 shares (47%) of the common stock and petitioner continued to hold 51 shares (51%) (Fdg. 7, App. p. 14a). Thereafter, and prior to February 1, 1944, Mr. Duke, after obtaining advice of the corporation's tax counsel, proposed that a partnership be formed and that the corporation lease its hotel to that partnership (Fdg. 8, App. p. 14a). On February 1, 1944, an agreement was signed by Messrs. Duke and Colvert, and Mrs. Martha Garner Price, forming a partnership under the firm name of King Cotton Hotel.

On the same date Cotton States Hotel Co. leased its hotel complete with furniture, furnishings, equipment and inventories to the partnership for 20 years at a rental of $5,000 per month (Fdg. 9, App. p. 15a).

Under the partnership agreement, Mr. Duke's capital contribution was 47½%, Mrs. Price's was 47½%, and Mr. Colvert's was 5%, and they were to share profits and losses in the same proportion. Messrs. Duke and Colvert were to draw designated salaries for full time employment (Fdg. 10, App. p. 16a). Each partner paid in his capital contribution, and operation of the hotel by the partnership began February 1, 1944. The operation was continued under the partnership agreement and under the lease until June 1, 1949 (Fdg. 11, App. p. 17a).

Although Mrs. Price had no prescribed duties under the partnership agreement she actively participated in many activities and contributed measurably to the successful operations of the partnership. The provision of the partnership agreement that "all matters of importance shall be approved by all partners" was fully observed (Fdg. 12, App. p. 18a).

From the beginning of operations by the partnership, cash receipts were sufficient to meet partnership obligations (Fdg. 11, footnote 4, App. p. 17a). The partnership returns filed with the Commissioner of Internal Revenue for the fiscal years ended January 31, 1945, 1946 and 1947, reported the net income of the partnership and the distributive shares of each partner (including salaries for Messrs. Duke and Colvert) (Fdg. 13, App. p. 18a). Based on an examination by a revenue agent, the Commissioner held that the partnership net income for each year was correctly reported; that Mr. Duke and Mr. Colvert were valid

partners; but that the petitioner, rather than his wife, Martha Garner Price, was the partner because of his alleged control of the lease through his 51% ownership of voting stock (Fdgs. 20, 21, App. pp. 22a, 23a). On June 1, 1949, Mrs. Price sold her partnership interest to outside parties for $100,000, and the partnership was formally dissolved July 15, 1952 (Fdg. 22, App. p. 24a).

The petitioner never intended to be a partner, and never participated in partnership affairs. It is inferred that Mrs. Price was a more active participant in partnership affairs than petitioner would have been if he had undertaken it (Fdg. 30(b), footnote 14, App. p. 28a).

The above are from the Court's findings. It is abundantly clear that all the evidentiary facts found by the Court bearing on the intention of the parties to form a partnership lead inevitably to the ultimate conclusion and fact that Martha Garner Price was the partner under the *Culbertson* case, *supra*. And just as irresistibly they negate any thought that the petitioner was a partner. The decision of the Court below that Mrs. Price's partnership income was taxable to the petitioner, and not to her, is opposed to, rather than based upon, the Court's own findings of fact, and is therefore arbitrary.

Throughout the opinion Mrs. Price is repeatedly referred to as the "partner" but nowhere is the petitioner so characterized. How then can he be taxed as a partner? And on no other predicate consistent with *Culbertson, supra,* can he be taxed. The successful operations of the partnership were due to the activities of the partners. The petitioner never participated in such activities and never intended to. Obviously he had no right to any portion of the partnership income,

nor did he receive any. Under these circumstances it is respectfully submitted that this Court should review the decision below.

III. The lower Court's primary conclusion begs the question in vague language and by specious reasoning

Referring to the termination clause of the lease between the corporation and the partnership, the majority opinion of the lower court stated its principal ground for decision as follows (App. p. 10a):

> We believe that the Commissioner properly taxed the income received by Mrs. Price under such circumstances to plaintiff because of this termination clause on the ground that the transaction insofar as plaintiff was concerned lacked substance and was a tax sham.

We first inquire, what was "the transaction" which "insofar as plaintiff was concerned lacked substance and was a tax sham?" It could not be a transaction between petitioner and the partnership involving plaintiff's affairs, because he was never a partner. And if the antecedent of "the transaction" was the lease which contained the termination clause[9] it is sufficient at this point to direct attention to the fact that the petitioner as an individual was not a party to the lease. The lease was between the corporation as lessor, and the ~~plaintiff~~ partnership as lessee. And in the second preceding paragraph of the opinion the Court has already held that "the evidence in this case fails to show that the rental charged the partnership was unfair or unreasonable."

Earlier in the opinion (App. p. 9a) the Court stated "The defendant bases a large part of its argument on

[9] The effect of the termination clause is discussed under Reason V, *infra*, p. 20.

the thought that this whole transaction was done for the purpose of avoiding or minimizing taxes." Presumably the "whole transaction" refers to the formation of a partnership and the leasing of the hotel by the corporation to that partnership, but the Court disposes of the Government's contention summarily by stating "This argument is without significance because it is well settled that taxpayers have the legal right to decrease the amount of what otherwise would be their taxes, or altogether avoid them, by means which the law permits."

Having rejected the Government's argument, we find the Court below in the anomalous position of pointing to the petitioner's ownership of 51% of the voting stock of the corporation, from which it is reasoned that the petitioner controlled the corporation and, by reason thereof "because of this termination clause, had complete economic control over the hotel, the income producing property." (App. p. 10a).[10] Let us examine that statement. The petitioner was nominally the president of the corporation and drew a small salary. His principal activities, however, were with Jefferson Standard Life Insurance Co., of which he was Executive Vice President. Even indulging the assumption that petitioner's 51% ownership of the corporation gave him absolute control of the corporation, and the further assuming that he could have caused the corporation to terminate the lease to the partnership, we fall far short of reaching the conclusion of the Court below in the language quoted.

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[10] The device of affixing a label to a situation as the basis for begging the question is deplored in *Scofield* v. *Mauritz*, *supra* (206 F. 2d at p. 140). In the instant case, the Court below rejected the Government's lyrics, but the melody lingers on.

When the opinion refers to "complete economic control over the hotel" it uses ambiguous language since the hotel was owned by the corporation, and leased and operated by the partnership. But when the opinion adds the descriptive phrase "the income producing property" it must be referring to the operation of the hotel by the partnership under the lease. The Court has already held that the rental paid by the partnership was fair and reasonable, and if, after paying such rental, the partnership was able to produce a large net income for its partners it was attributable to the abilities and activities of the partners. Surely it cannot be said that in this field the petitioner could or did exercise any control. Neither the Commissioner nor the Court below has gone so far as to say that the petitioner had any control over, or should be taxed on, the respective shares of partnership income of Messrs. Duke and Colvert. Had they done so, they would at least have been consistent in principle, though more egregiously in error.

When the opinion below draws a comparison between the "undistributed share" of the corporate stockholders in the "profits from the hotel" prior to the lease, and the "profits of the hotel" realized by the partners from operations under the lease (App. p. 10a), it again indulges in ambiguous language and specious reasoning. It is idle to speak of a stockholder's undistributed share of a corporation's net income, either for tax purposes or otherwise. It is also inadmissible to ignore the separate status of a partnership, both under the tax laws and under general law. As Mr. Justice Frankfurter succinctly stated in his concurring opinion in the *Culbertson* case, *supra*:[11]

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[11] 337 U.S. at p. 751.

> But Secs. 181 and 182 import a concept of a different sort. These sections make taxability turn on the existence of the relation of "partnership." The term carries its own meaning, just as does "negligence" in the Federal Employers' Liability Act, because such a common-law concept has a content familiar throughout the country to those to whom the law speaks. The basic criteria which determine its applicability have been so well and so long established that they were implicitly incorporated by the Internal Revenue Code's definition of "partnership." Congress has thereby stamped a nationwide meaning upon the term which disregards minor local variants or an occasional legal sport.

The majority opinion cites *Ingle Coal Corporation* v. *United States*, 131 C. Cls. 121, cert. den. 350 U.S. 842, in support of its conclusion. That case is readily distinguishable since there the facts clearly showed that a new corporation was formed solely for the purpose of avoiding tax by means of providing for payment of an overriding royalty to the stockholders.

IV. The lower Court's further conclusion that petitioner assigned his income to his wife is wholly unsupported in fact or in law

The concluding sentence in the majority opinion of the Court of Claims reads:

> The taxes are also sustainable on the ground that plaintiff anticipatorily assigned his right to a portion of the income from the hotel. *Helvering* v. *Horst*, 311 U.S. 112; *Helvering* v. *Eubank*, 311 U.S. 122; *Harrison* v. *Schaffner*, 312 U.S. 579; *Commissioner* v. *Sunnen*, 333 U.S. 591.

First, from a factual standpoint the Court below erred in stating that the petitioner "assigned his right

to a portion of the income from the hotel".[12] Presumably the words "income from the hotel" refer to partnership income and more specifically to Mrs. Price's distributive share thereof, since the income to the corporation as rental under the lease is not in controversy. But before the petitioner could have assigned his right to the income it must first appear that the income was his. Not a single finding of the Court of Claims warrants even the suggestion that the petitioner at any time had any right to any of the partnership income, nor is there any finding that the petitioner was a member of the partnership.

The cases cited, namely *Helvering* v. *Horst,* 311 U.S. 112; *Helvering* v. *Eubank,* 311 U.S. 122; *Harrison* v. *Schaffner,* 312 U.S. 579 and *Commissioner* v. *Sunnen,* 333 U.S. 591, are a few of the many cases dealing with the anticipatory assignment of income and the resulting tax effect. All such cases deal with the economic significance of the word "income" as it appears in section 22(a) of the Internal Revenue Code. But the concurring opinion by Mr. Justice Frankfurter in the *Culbertson* case, *supra* (337 U.S. at pp. 750-751) points out the distinction between an issue of that sort and one which involves partnerships.

Again we come back to the basic proposition that there was only one issue before the Court of Claims, and that issue was whether the petitioner, instead of his wife, was a partner in the King Cotton Hotel partnership. That issue can be resolved only on the facts and under the law as prescribed in the Internal Revenue Code and as defined in *Commissioner* v. *Culbertson,* 337 U.S. 733. For failure to decide the instant case

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[12] The ambiguous and misleading label as the basis for begging the question persists. See note 10, *supra,* p. 16.

on its facts pursuant to that law, the Court of Claims clearly erred. Equally clearly, it erred in its attempt to decide the case under provisions of law which are wholly inapplicable.

V. The termination clause in the lease had no legal effect on the issue

Both the Commissioner of Internal Revenue and the Court below laid great stress on the termination clause in the lease from the corporation to the partnership, which reads:

> It is understood and agreed that inasmuch as the Lessees are not required to post a good and sufficient bond guaranteeing full performance on the part of said Lessees, the Lessor, at its option, may, with or without cause, and in its absolute discretion, terminate this lease at any time upon giving sixty (60) days' written notice to the Lessees.

By its own terms the termination clause sets forth the reason for its inclusion in the lease, namely to protect the lessor in the absence of a good and sufficient bond guaranteeing full performance by the lessees.

Footnote 3 to finding 9(c) (App. p. 15a) infers that the reason for this clause may have been to protect the Price interests since Mrs. Price would have been more able to respond financially in the event of partnership difficulties than would either of her partners.

At most, the termination clause, which was effective only upon 60 days' notice, had the practical effect of creating a tenancy at will. It is not to be denied that such a tenancy would be perfectly valid so long as it existed and here the lease continued not only through

the three year period in controversy, but for more than two years thereafter.

Assuming, arguendo, that the lease had been terminated—the partnership would then be out of business, but no portion of the partnership income which had been earned prior to the actual termination would have reverted to the corporation, nor to the petitioner as one of its stockholders, so it cannot be said that either the petitioner or the corporation had any control over partnership income already earned.

Neither the Commissioner of Internal Revenue nor the Court question the validity, as such, of the lease between the corporation and the partnership. Indeed, the opinion states that the rental was not unfair or unreasonable. That should have exhausted its inquiry into the lease.

The income which the partnership was able to produce in its successful operation of the hotel under the lease is in no wise affected by the possibility that it might have to cease operations if the corporation exercised its right to terminate the lease. The obvious purpose of the termination clause was to guarantee that the corporation would collect its rent. Footnote 4 to finding 11 (App. p. 17a) shows that there was no cause for apprehension on that score.

This is quite a different situation from that which existed in *Commissioner* v. *Sunnen*, 333 U.S. 591, involving a transaction between a corporation and its majority stockholder, under which the amount of income to be received by the stockholder or his assignee was wholly within the control of the stockholder. That case involved economic income under section 22(a) of the Internal Revenue Code, while the case at bar

involves a partnership issue under sections 181 and 182 of the Code, an entirely different concept.[13]

CONCLUSION

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari to the United States Court of Claims should be granted.

STANLEY WORTH
EDWARD S. SMITH
404 Transportation Building
Washington 6, D. C.

D. NEWTON FARNELL, JR.
Jefferson Standard Building
Greensboro, North Carolina

Counsel for Petitioner

Of Counsel:

BLAIR, KORNER, DOYLE & WORTH

DECEMBER 1956.

[13] *Commissioner* v. *Culbertson, supra,* at pp. 750-751.

APPENDIX

APPENDIX

APPENDIX

STATUTES INVOLVED

Internal Revenue Code of 1939, as amended (26 U.S.C.A.—1944 Edition)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As part of his gains and losses from sales or exchanges of capital assets held for not more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than 6 months.

(b) As part of his gains and losses from sales or exchanges of capital assets held for more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) General Rule.—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b), (c), and (d).

(b) Segregation of Items.—

(1) Capital Gains and Losses.—There shall be segregated the gains and losses from sales or exchanges of capital assets.

(2) Ordinary Net Income or Loss.—After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

(c) Charitable Contributions.—In computing the net income of the partnership the so-called "charitable contribution" deduction allowed by section 23 (o) shall not be allowed; but each partner shall be considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which was made by the partnership within its taxable year, of the character which would be allowed to the partnership as a deduction under such section if this subsection had not been enacted.

(d) Standard Deduction.—In computing the net income of the partnership, the standard deduction provided in section 23 (aa) shall not be allowed.

SEC. 187. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

SEC. 188. DIFFERENT TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner.

Opinion, Findings of Fact, and Conclusion of Law of the United States Court of Claims

No. 597-53

(Decided July 12, 1956)

RALPH C. PRICE

v.

THE UNITED STATES

MARTHA GARNER PRICE, THIRD PARTY, DEFENDANT

OPINION

LARAMORE, *Judge*, delivered the opinion of the court:

This is a suit to recover an alleged overpayment of Federal income taxes and interest for the calendar years 1945, 1946, and 1947. The sole issue is whether part of the income of the King Cotton Hotel partnership should be taxed to plaintiff, as the defendant contends, or to the plaintiff's wife, as the plaintiff contends. The plaintiff's wife was made a third party defendant because if the court decides that plaintiff is entitled to recover she will be required to repay the taxes refunded to her by the Commissioner as a result of his action of taxing the income to plaintiff.

The facts as found by the commissioner of this court may be summarized as follows: The plaintiff and his sister were the only children and heirs of the late Julian Price, who died in October 1946, leaving an estate worth between 3 and 4 million dollars. Mr. Julian Price was president of the Jefferson Standard Life Insurance Company from 1919 until January 1946 when he became chairman of the board and plaintiff became president. The plaintiff had been executive vice president for some time theretofore.

At the time of her marriage to plaintiff in 1937, Mrs. Price had no substantial wealth of her own. In 1943 her gross income was just over $4,350, practically all of which was dividend income from stock given to her by her husband or her father-in-law.

Sometime during the 1930's plaintiff acquired 51 of the 100 shares of the voting common stock of a North Carolina corporation named the Cotton States Hotel Company, which owned the physical plant and operated the business of the King Cotton Hotel in Greensboro, North Carolina. Forty-seven shares were owned by another family. The corporation also had outstanding $125,000 in nonvoting preferred stock. During the early part of 1937 the corporation employed as manager of the hotel Mr. Haywood Duke, a young hotel executive whose work in another town had made a favorable impression upon the Prices. The assistant manager, employed at the same time, was Mr. Harold Colvert, who had served the King Cotton Hotel in other capacities.

During World War II installations of the armed services were located in or near Greensboro. The camps gave a fillip to the local hotel business. The year 1943 was the most profitable year, up to that time, in the history of the Cotton States Hotel Company. Its gross profits for that year were, in round numbers, $179,000, and its net income was $88,000. Although Mr. Duke held only one qualifying share in the corporation, he prospered with the hotel in 1943. He had been employed on the basis of

a fixed salary of $4,500 plus a percentage of the profits. His compensation from the position for 1943 was in excess of $21,000.

In June 1943, a proposal was placed before a meeting of the stockholders of the corporation for the lease of the physical plant by the corporation to a partnership to be composed of Mr. Duke and plaintiff, the hotel business to be operated by the partnership. The proposal was rejected. Toward the end of 1943, or early in 1944, while the outlook for the business of King Cotton continued favorable, Mr. Duke, with the assistance of Mr. Julian Price, borrowed money with which to purchase the 47 shares of the voting stock mentioned above. The security which Mr. Duke gave for the loan absorbed all of his available credit. The stock purchase was consummated before February 1, 1944. After the purchase by Mr. Duke, he held 47 shares of the voting stock in the corporation, while plaintiff continued to hold 51 shares. The remaining shares were held by other individuals.

Mr. Duke discussed with the corporation's tax consultant the feasibility of transferring the operations of the hotel to a partnership. Thereafter Mr. Duke's partnership proposal was discussed by Mr. Duke, Mr. Julian Price, plaintiff, and his wife. On February 1, 1944, an agreement was signed by Mr. Duke, Mrs. Price, and Mr. Colvert, forming a partnership under the firm name of King Cotton Hotel. On the same day, Cotton States Hotel Company leased the hotel building to the partnership for a term of 20 years at a rental of $5,000 per month. All of the hotel's furnishings, fixtures, equipment, and inventories were included in the lease, and the lessees agreed to make and pay for all repairs and replacements necessary to maintain the building, equipment, and furnishings "in substantially their present condition," reasonable wear and tear and loss by fire or other casualty excepted. The lessor undertook the fire insurance, while the lessees agreed to obtain and pay for public liability insurance in such amounts as the lessor

should from time to time determine. The lease contained the following clause:

> It is understood and agreed that inasmuch as the Lessees are not required to post a good and sufficient bond guaranteeing full performance on the part of said Lessees, the Lessor, at its option, may, with or without cause, and in its absolute discretion, terminate this lease at any time upon giving sixty (60) days' written notice to the Lessees.

The partnership agreement, which is set forth in full in finding 10, is of the usual general partnership type. It stated, *inter alia*, that the operating capital of the partnership that had been contributed by partners was $1,425 by Haywood Duke, $1,425 by Martha Garner Price, and $150 by Harold Colvert. It also provided that the duties and salaries of the partners could at any time be changed by unanimous consent, and that all matters of importance should be approved by all the partners. It provided that Haywood Duke should give the business his entire time and attention as general manager of the business and was to receive the monthly salary of $500. It provided that Harold Colvert should give the business his entire time and attention as assistant manager and should receive a monthly salary of $250. It also provided that the profits and losses of the partnership should be shared 47½ percent by Haywood Duke, 47½ percent by Martha Garner Price, and 5 percent by Harold Colvert.

Each of the partners paid into the partnership fund the sum listed in the agreement, and operation of the hotel by the partnership was begun on February 1, 1944. The operation continued, under the terms of the partnership agreement and under the lease from the corporate owner, until June 1, 1949.

Mr. Duke was intent upon gaining and holding recognition of the King Cotton as the leading hotel in Greensboro. Mrs. Price supported Mr. Duke in this endeavor, before as well as after the formation of the partnership. After the

partnership agreement her activities in this respect were more sustained and direct. Her judgment and tastes were then consulted and reflected in the selection of furnishings and interior decorations. She brought the hotel's facilities to the attention of various local groups and organizations interested in such facilities for meetings, luncheons, cocktail parties, and dances.

Mr. Duke was primarily responsible for all decisions of a strictly business nature. His partners, Mrs. Price and Mr. Colvert, had complete confidence in his judgment on such matters, and left to him all decisions, except those concerning major expenditures. The partners jointly conferred and decided on such items as a contract of elevators, amounting to approximately $50,000, a boiler installation at a cost of approximately $30,000, and substantial purchases, actual and proposed, of furniture. While the partners did not meet regularly or on any fixed schedule, they did assemble once or twice a month, and the provision in their agreement that "all matters of importance shall be approved by all of the partners" was fully observed.

The partnership prospered and Mrs. Price received as her share of the net income $60,055.42 for 1945; $77,532.44 for 1946, and $79,676.36 for 1947.

Prior to the formation of the partnership Mrs. Price received $500 a month allowance from plaintiff, which she spent for household expenses. The balance of the household expenses were paid by plaintiff. Subsequent to the formation of the partnership the allowance was discontinued and Mrs. Price spent considerable sums for household expenses, including direct obligations of plaintiff. She invested some of her earnings and disbursed some to plaintiff. During this period plaintiff reported as net income and paid taxes on $135,456.54 for 1945; $60,989.70 for 1946, and $108,302.72 for 1947.

Mr. Julian Price died in 1946 and plaintiff and his sister inherited, *inter alia*, his home valued at $75,000. Plaintiff purchased his sister's undivided one-half interest for

$37,500 and on January 2, 1947, conveyed it to himself and his wife as tenants by the entireties.

In December 1948 an internal revenue agent began an audit of plaintiff's income tax returns for the years 1945, 1946, and 1947. The same agent examined the returns made by the King Cotton Hotel partnership for its fiscal years ending January 31, 1945, 1946, and 1947, and then examined Mrs. Price's returns for the calendar years 1945, 1946, and 1947. On January 6, 1949, the agent orally informed plaintiff of his intention to recommend that plaintiff be taxed with the partnership income reported by Mrs. Price because of the use of this income for family and other expenses normally paid by the husband.

After the above discussion, Mrs. Price examined her check stubs and listed certain payments as shown thereon during the period extending from March 1, 1944, through January 31, 1949. This list was given her accountant and he wrote a letter to plaintiff's attorney which pointed out that Mrs. Price had paid certain expenses for plaintiff and had loaned him certain sums. It also stated that Mrs. Price had acquired a one-half interest in the home of Mr. Julian Price at a price of $37,500. It concluded with the suggestion that a note, bearing interest, should be given for the net amount, $76,539.24. A note was given for $76,539.24, bearing interest at the rate of 4½ percent per annum, on February 14, 1949. This note was subsequently paid with interest.

Negotiations were completed during May 1949 for the transfer of the King Cotton Hotel to the Alsonett hotel chain. Alsonett made offers to the members of the partnership and to the stockholders of Cotton States Hotel Company. The written offer to Mrs. Price of $100,000 for her interest in the partnership, which she accepted, was dated May 17, 1949. On May 9, 1949, at the instance of Alsonett, the lease from Cotton States Hotel Company to the partnership was amended to eliminate the termination clause, increase the rent, and reduce the term. The sale

was consummated on or about June 1, 1949. After the sale, Mr. Duke remained with the King Cotton Hotel as manager. The partnership was formally dissolved on July 15, 1952.

The Commissioner assessed deficiencies against plaintiff in the total sum of $175,098.60, with interest of $24,307.33, based upon taxing to plaintiff the partnership income reported by Mrs. Price. The plaintiff paid these sums, filed claims for refund which were rejected, and timely instituted this suit. The Commissioner refunded to Mrs. Price taxes and interest for these years in the total amount of $141,812.03.

The plaintiff contends that the facts show that Mrs. Price was the member of the valid partnership and that plaintiff was not and never intended to be a member of the partnership. The defendant contends that the whole transaction was a tax sham and should be ignored for tax purposes.

The defendant bases a large part of its argument on the thought that this whole transaction was done for the purpose of avoiding or minimizing taxes. This argument is without significance because it is well settled that taxpayers have the legal right to decrease the amount of what otherwise would be their taxes, or altogether avoid them, by means which the law permits. The taxpayer is not required to carry out its transactions in a way that will produce the most tax for the Government. *United States* v. *Isham,* 17 Wall. 496, 506; *Gregory* v. *Helvering,* 293 U. S. 465, 469; *Commissioner* v. *Tower,* 327 U. S. 280; *Chamberlin* v. *Commissioner,* 207 F. 2d 462, 468; *Zenz* v. *Quinlivan,* 213 F. 2d 914, 916; *The Coca-Cola Company* v. *United States,* 97 C. Cls. 241, 261.

It is, of course, true that transactions between or involving members of a family are subject to close scrutiny. This means that such transactions must be fair and reasonable judged by the standard of transactions entered into by parties dealing at arm's length, and must be based upon

substance as opposed to mere form. See the cases cited in *Ingle Coal Corporation* v. *United States,* 131 C. Cls. 121, cert. denied 350 U. S. 842.

The change of operation of a hotel from a corporation to a partnership would ordinarily be considered more than a mere formality because the partners become subject to personal liability and all the other attributes of a partnership. Also the evidence in this case fails to show that the rent charged the partnership was unfair or unreasonable. However, the lease in this case contained a termination clause that gave the corporation and plaintiff complete control over the hotel. The termination clause expressly gave the corporation the absolute discretion to terminate the lease without cause upon the giving of 60 days' notice.

The plaintiff owned 51 percent of the voting stock of the corporation and therefore controlled the corporation. Through his control of the corporation, plaintiff, because of this termination clause, had complete economic control over the hotel, the income producing property. Before the hotel was leased to the partnership plaintiff's undistributed share in the profits from the hotel, after the payment of preferred dividends, was 51 percent and Mr. Duke's was 47 percent. After the hotel was leased, Mrs. Price received 47½ percent of the profits of the hotel. Thus Mr. Duke's position remained substantially unchanged and plaintiff retained control over the property and Mrs. Price received substantially the same income that plaintiff would have received had he been the partner.

We believe that the Commissioner properly taxed the income received by Mrs. Price under such circumstances to plaintiff because of this termination clause on the ground that the transaction insofar as plaintiff was concerned lacked substance and was a tax sham. See *Ingle Coal Corporation* v. *United States, supra,* and the cases cited therein. The taxes are also sustainable on the ground that plaintiff anticipatorily assigned his right to a portion of the income from the hotel. *Helvering* v. *Horst,* 311 U. S.

112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Schaffner*, 312 U. S. 579; *Commissioner* v. *Sunnen*, 333 U. S. 591.

The plaintiff's petition and the third party complaint are dismissed.

It is so ordered.

MADDEN, *Judge*, and JONES, *Chief Judge*, concur.

WHITAKER, *Judge*, and LITTLETON, *Judge*, dissent.

FINDINGS OF FACT

The court, having considered the evidence, the report of Commissioner W. Ney Evans, and the briefs and argument of counsel, makes findings of fact as follows:

1. Plaintiff and the third party defendant are husband and wife. Their home is, and since their marriage in 1937 has been, in Greensboro, North Carolina. They have three children, whose ages in 1955 (at the time of the trial of this action) were 16, 13, and 11.[1] Plaintiff's age at that time was 53.

2. Plaintiff and his sister (also a resident of Greensboro) were the only children and only heirs of the late Julian Price, who died in October 1946, leaving an estate worth between three and four million dollars. Mr. Julian Price was president of the Jefferson Standard Life Insurance Company (hereinafter sometimes referred to as Jefferson Standard) from 1919 until January 1946, when he became chairman of the board and plaintiff became president. Plaintiff had been executive vice president for some time theretofore. By 1946 Mr. Julian Price held a larger block of stock in Jefferson Standard than any other individual, and several thousand additional shares were held by

[1] For each of the calendar years with which this case is concerned (1945, 1946, and 1947), separate individual income tax returns were filed by each of the Price children as well as by each of the parents.

members of his family. Plaintiff's holdings at that time comprised some 50,000 or 60,000 shares.

3. Jefferson Standard retained the services of accountants and attorneys for consultation and advice in tax matters. From time to time the Prices, father and son, consulted the same accountants and attorneys in matters pertaining to tax liabilities, actual or potential, in their individual business and personal affairs.

During the last ten years of his life Mr. Julian Price was particularly concerned with tax matters. He had amassed a sizable fortune, he was in receipt of a large income, and he was past midle age. The accountant who was his tax adviser was continually urging him to transfer holdings to his wife and children and grandchildren. Similar advice was given to plaintiff by the same tax adviser. Both plaintiff and his father acted on the advice to some extent, making some transfers and gifts each year. As a consequence both men were aware and had some knowledge of the requirements of gift and estate taxes, while their business activities kept them aware of income tax requirements, both corporate and personal.

4. At the time of her marriage to plaintiff (in 1937) Mrs. Price had no substantial wealth of her own. Six years later (in 1943) her gross income was just over $4,350, practically all of which was dividend income from stock given to her by her husband or her father-in-law, most of the shares being Jefferson Standard.

5. Sometime during the 1930's there came within the orbit of Price property holdings a North Carolina corporation named the Cotton States Hotel Company, which owned the physical plant and operated the business of the King Cotton Hotel in Greensboro. During the early months of 1937 (before plaintiff's marriage) the corporation, acting upon the recommendation of Mr. Julian Price and plaintiff, employed as manager of the hotel Mr. Haywood Duke,

a young hotel executive whose work in another North Carolina town had made a favorable impression upon the Prices.

Mr. Duke became manager of the hotel in May 1937. The assistant manager, employed at the same time, was Mr. Harold Colvert, who had theretofore served the King Cotton in other capacities.

After plaintiff's marriage (in October 1937) he and Mrs. Price lived for some time at the King Cotton.

6. (a) During World War II installations of the armed services were located in or near Greensboro. The camps gave a fillip to the local hotel business. The year 1943 was the most profitable year, up to that time, in the history of the Cotton States Hotel Company. Its gross profits for that year were, in round numbers, $179,000, while its net income (after substantial absorptions of depreciation) was $88,000.

(b) At that time plaintiff owned 51 of the 100 shares of the voting (common) stock of the corporation. Forty-seven shares were owned by another family (husband and wife). The corporation also had outstanding $125,000 in preferred (non-voting) stock.

(c) Although Mr. Duke held only one (qualifying) share in the corporation, he prospered with the hotel in 1943. He had been employed on the basis of a fixed salary of $4,500, plus a percentage of the profits. His compensation from the position for the year 1943 was in excess of $21,000.

(d) In June 1943, a proposal was placed before a meeting of the stockholders of the corporation for the lease of the physical plant by the corporation to a partnership to be composed of Mr. Duke and plaintiff, the hotel business to be operated by the partnership. The proposal was rejected a few days later at another meeting of the stockholders.

7. Toward the end of 1943, or early in 1944, while the outlook for business at the King Cotton continued favorable, Mr. Duke, with the assistance of Mr. Julian Price,

borrowed money with which to purchase the 47 shares of common (voting) stock hereinabove mentioned. The security which Mr. Duke gave for the loan absorbed all of his available credit.

The stock purchase was consummated before February 1, 1944. After the purchase by Mr. Duke, he held 47 shares in the corporation, while plaintiff continued to hold 51 shares. The two remaining shares were held by other individuals.

8. Sometime after his stock purchase and before February 1, 1944, Mr. Duke sought the opinion of the corporation's auditor (who was also tax consultant for the corporation and for Mr. Duke personally) as to the feasibility of transferring the operation of the hotel business from the corporation to a partnership composed of the stockholders, in order to eliminate the payment of excess profits taxes by the corporation. The consultant advised Mr. Duke that if the persons comprising the partnership owned respectively the same interest in it as they did in the corporation, there was likelihood that Internal Revenue would look through the arrangement and tax the corporation for the partnership income. The consultant advised Mr. Duke that the device would be more likely to succeed if one member of the partnership was not a stockholder in the corporation.

Thereafter, Mr. Duke's partnership proposal was discussed at a conference in which he participated with plaintiff, Mr. Julian Price, and an attorney. Mrs. Price was not present at the meeting, but the proposal was later discussed with her by plaintiff, Mr. Julian Price, and Mr. Duke.

9. (a) On February 1, 1944, an agreement was signed by Mr. Duke, Mrs. Price, and Mr. Colvert, forming a partnership under the firm name of King Cotton Hotel.

Mr. Julian Price was present when the agreement was signed. Plaintiff was not.

(b) On February 1, 1944, Cotton States Hotel Company leased the hotel building to the partnership King Cotton Hotel for a term of 20 years at a rental of $5,000 per month.[2] All of the hotel's furnishings, fixtures, equipment, and inventories were included in the lease, and the lessees agreed to make and pay for all repairs and replacemnts necessary to maintain the building, equipment, and furnishings "in substantially their present condition," reasonable wear and tear and loss by fire or other casualty excepted. The lessor undertook the fire insurance, while the lessees agreed to obtain and pay for public liability insurance in such amounts as the lessor should from time to time determine.

(c) The lease contained the following clause:[3]

> It is understood and agreed that inasmuch as the Lessees are not required to post a good and sufficient bond guaranteeing full performance on the part of said Lessees, the Lessor, at its option, may, with or without cause, and in its absolute discretion, terminate this lease at any time upon giving sixty (60) days' written notice to the Lessees.

10. The text of the partnership agreement described in the preceding finding was as follows:

> That said parties do hereby contract and agree to form a partnership for the purpose and upon the terms and conditions herein set out.

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[2] While the evidence is silent as to the expenses of the corporation (except for an annual salary of $2,500 paid to plaintiff as its president) and as to any distributions by it to shareholders, there may be noted the potential of income to plaintiff and Mr. Duke.

[3] The reason for the insertion of this clause is not explained by the evidence. Inferentially, it appears to have been devised for protection of the Price interests, since Mrs. Price would have been more able at that time than either of the other two partners to respond financially in the event of partnership liabilities exceeding its income and limited capital.

1. The firm name of this partnership shall be "King Cotton Hotel" and all business of any kind whatsoever shall be done under said name.

2. This partnership is formed for the purpose of engaging in the business of leasing and operating the King Cotton Hotel at Greensboro, North Carolina.

3. The office and principal place of business of this partnership shall be in the City of Greensboro, County of Guilford, State of North Carolina.

4. This partnership shall begin as of the first day of February, 1944, and shall exist and continue until one of the partners has given to the others written notice of his or her intention to dissolve this partnership, or until the death of a partner.

5. The operating capital of this partnership shall be Three Thousand Dollars ($3,000.00) which has been contributed by the partners as follows:

Haywood Duke	$1,425.00
Martha Garner Price	1,425.00
Harold Colvert	150.00

6. The duties and salaries of the partners may at any time be changed by unanimous consent, and all matters of importance shall be approved by all the partners, but until changed, the duties and salaries shall be as follows:

"Haywood Duke shall give to the business his entire time and attention as General Manager of the business and for his services shall receive a monthly salary of Five Hundred Dollars ($500.00)

"Harold Colvert shall give to the business his entire time and attention as Assistant Manager or Resident Manager and for his services shall receive a monthly salary of Two Hundred & Fifty Dollars ($250.00)."

7. Neither partner shall, without the knowledge and consent of the other partners, sign in the name of the partnership any note, draft, or other written obligation for the payment of money, except checks in payment of the ordinary and usual expenses incident to the operation of the hotel. Neither partner shall, without the knowledge and consent of the other partners, make

purchases upon open account in the name of the partnership except for such goods, wares and merchandise as may be necessary to carry on the routine business of the partnership.

8. The fiscal year of the partnership shall be from February 1st to January 31st, inclusive.

9. All profits made by the partnership shall be divided among the several partners as follows:

To Haywood Duke.....47½ per cent
To Martha Garner Price.....47½ per cent
To Harold Colvert..... 5 per cent

All losses, if the business should show a net loss, shall be borne by the several partners in the same proportions that profits would have been divided, under this contract, if the business had shown a profit.

11. Each of the partners paid into the partnership fund the sum listed in the agreement, and operation of the hotel by the partnership was begun on February 1, 1944.[4] The operation was continued, under the terms of the partnership agreement and under the lease from the corporate owner, until June 1, 1949.

12. From the time of his employment as manager, in May 1937, Mr. Duke was intent upon gaining and holding recognition of the King Cotton as the leading hotel in Greensboro. Mrs. Price supported Mr. Duke in this endeavor, before as well as after the formation of the partnership. After the partnership agreement her activities in this respect were more sustained and direct. Her judgment and tastes were then consulted and reflected in the selection of furnishings and interior decorations. She persuaded the manager and his assistant to initiate and maintain the custom of keeping fresh, cut flowers in the lobby and dining room. She brought the hotel's facilities to the attention of various local groups and organiza-

[4] Cash receipts from the hotel business proved sufficient from the start of the operation to meet the partnership's obligations.

tions interested in such facilities for meetings, luncheons, cocktail parties, and dances. Among the organizations was the local chapter of the Junior League.

Mr. Duke was primarily responsible for all decisions of a strictly business nature. His partners, Mrs. Price and Mr. Colvert, had complete confidence in his judgment on such matters, and left to him all decisions except those concerning major expenditures. The partners jointly conferred and decided on such items as a contract for elevators, amounting to approximately $50,000, a boiler installation at a cost of approximately $30,000, and substantial purchases (actual and proposed) of furniture.

While the partners did not meet regularly or on any fixed schedule, they did assemble once or twice a month, and the provision in their agreement that "all matters of importance shall be approved by all of the partners" was fully observed.

13. The partnership operation prospered. The Federal information returns filed on its behalf for its fiscal years ending January 31 of 1945, 1946, and 1947, reported total net income and partners' shares as follows:[5]

Partner	1945	1946	1947
Mr. Duke	$66,055.42	$83,532.14	$85,676.36
Mr. Colvert	9,446.62	11,161.27	11,386.99
Mrs. Price	60,055.42	77,532.44	79,676.36
Total	135,557.46	172,225.55	176,739.71

14. (a) Prior to February 1, 1944, Mrs. Price received from plaintiff a monthly allowance of $500, which she usually deposited at a local bank in the only checking account then (or later) maintained by her. Under this arrangement Mrs. Price paid some of the household expenses, using "allowance" money for the purpose, and the remainder of household and family expenses were paid by plaintiff.

[5] The shares listed for Mr. Duke and Mr. Colvert included their salaries.

(b) After February 1, 1944, the allowance was discontinued. Mrs. Price received from the King Cotton Hotel $500 per month from February through August and $1,000 per month from September through December, making a total of $7,500 from this source during 1944.[6] During the ten months of March through December 1944, she disbursed from her checking account a little more than $10,000, more than half of which was for household expenses. During this period plaintiff continued paying part of the household and family expenses.

(c) Mrs. Price's income during 1945 was (as shown by her income tax return) derived from dividends, capital gains, and returns from the partnership. Her disbursements amounted to $72,000, approximately, divided as follows: $24,000 for investments; $23,500 for income tax; $12,000 for household expenses; $4,200 withdrawn in cash (part of which was used for household and family expenses); $2,000 for insurance premiums; $2,000 in contributions; and $4,300 for miscellaneous expenditures.

(d) Mrs. Price's income during 1946 and 1947 was derived from the same or similar sources as in 1945. Her disbursements for those years followed the same pattern as the disbursements in 1945, except that (1) in 1946, instead of investments, she disbursed $33,000 to plaintiff[7] and deposited $8,000 in the children's savings accounts, from total disbursements of $72,000, and (2) in 1947, from total disbursements of $92,000, she made no investments

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[6] Mrs. Price's income tax return for calendar year 1944 is not in evidence, nor is it in issue here. On her returns for 1945, 1946, and 1947, she reported as partnership income the shares listed after her name in finding 13 (except that in 1945 she listed $58,875.84 instead of $60,055.42). Her 1944 income is material here only as the source from which her disbursements were made.

[7] Plaintiff used the $33,000 in the payment of his 1945 income tax.

but paid $50,000 on her income taxes and spent more than $30,000 for household expenses.[8]

15. The individual incomes received by plaintiff and Mrs. Price during the calendar years 1945, 1946, and 1947, as shown by their individual (Federal) income tax returns, were as follows:

	1945	1946	1947
Plaintiff	$135,456.54	$60,989.70	$108,302.72
Mrs. Price	80,007.06	84,855.64	88,331.36

Each of them paid the taxes reported on their returns as due on the incomes above listed.

16. When Mr. Julian Price died (in October 1946), plaintiff and his sister, as the only heirs, inherited their father's home, which was valued at $75,000. Plaintiff purchased from his sister, for $37,500, her undivided one-half interest in the residence. On January 2, 1947, by means of a straw party conveyance, the home was conveyed to plaintiff and Mrs. Price as tenants by the entireties.

17. In December 1948 an internal revenue agent began an audit of plaintiff's income tax returns for the years 1945, 1946, and 1947. The same agent at the same time examined the returns made by the King Cotton Hotel partnership for its fiscal years ending January 31, 1945, 1946, and 1947,[9] and then examined Mrs. Price's returns for the calendar years 1945, 1946, and 1947.

The revenue agent spoke to plaintiff about the audit and was referred by him to the Jefferson Standard accountant who then served as tax adviser to plaintiff and Mrs. Price. The tax adviser obtained and made available to the

[8] A substantial part of the latter sum was spent in redecorating the former home of Mr. Julian Price, into which plaintiff and his wife moved during 1947.

[9] No point has been made in this case of the obvious fact that the partnership returns cover income received during 11 months of 1944 and during only one month of 1947.

revenue agent the bank statements and canceled checks of Mrs. Price. The agent examined them in the accountant's office. Some of the checks of larger amounts were discussed by the two men, and the agent noted some of them on a list he was making.

On January 6, 1949, the agent orally informed plaintiff of his intention to recommend that plaintiff be taxed with the partnership income (from King Cotton Hotel) reported by Mrs. Price because of the use of this income for family and other expenses normally paid by the husband. Two weeks later, on January 20, 1949, the agent filed his report which formally recommended as stated above.

18. After the conference described in the preceding finding, plaintiff and Mrs. Price examined her check stubs and listed certain payments as shown thereon during the period extending from March 1, 1944, through January 31, 1949. Plaintiff gave this list to the accountant, who then wrote to the attorney as follows:

> From March 1, 1944, until January 31, 1949, Mrs. Martha Garner Price paid household expenses, amounting to $82,115.93. These household expenses should have been paid by Mr. Ralph C. Price. Attached is the original statement; also a photostat of it, showing individual items expended.
>
> Mrs. Martha Garner Price made the following loans to Mr. Ralph C. Price:

February 24, 1945	$700.00
January 14, 1946	30,000.00
March 14, 1946	3,000.00
	33,700.00

Mr. Price partly repaid these loans as follows:

June 7, 1948	$4,000.00
July 1, 1948	3,000.00
	7,000.00

leaving a balance of $26,700.00 due Mrs. Martha Garner Price.

On January 2, 1947, Mrs. Martha Garner Price acquired from Ralph C. Price a one-half interest in the home of Mr. Julian Price, deceased, at a price of $37,500.00.

Because of the foregoing transactions, Mr. Ralph C. Price is now indebted to Mrs. Martha Garner Price in the amount of $71,315.93, plus interest at 6% from the date of the transactions to date. The amount of interest to February 8, 1949, is $5,223.31.

It is suggested that he give her a note, dated today, secured by proper collateral, for $76,539.24, which is the amount of the principal plus the interest accrued to date. The note should bear 6% interest. Attached to this note should be a copy of this letter, which is enclosed, and a photostat of the individual items expended by Mrs. Price for Mr. Price.

The original statement should be retained in her permanent files.

19. On February 14, 1949, plaintiff gave to Mrs. Price his note payable on demand for $76,539.24, bearing interest at the rate of 4½ percent.

20. On May 9, 1949, in so-called 30-day letters, the Internal Revenue Agent in Charge transmitted to plaintiff, to Mrs. Price, and to the King Cotton Hotel partnership copies of the reports made by the revenue agent on January 20, 1949. These letters and reports proposed the assessment of deficiencies against plaintiff and the scheduling of refunds to Mrs. Price, based upon taxing to plaintiff rather than to Mrs. Price the income from the King Cotton Hotel partnership that had been reported for tax by her for the years 1945, 1946, and 1947.

21. (a) Following are excerpts from the revenue agent's report relating to the partnership:

* * * The principal and only change herein is in the distribution of partnership income which is based on

the determination that Mr. Ralph C. Price is a partner rather than his wife, Mrs. Martha Garner Price.

* * * * *

The validity of Mr. Duke and Mr. Colvert as partners is not questioned. Mr. Duke owns 47% of the common stock of the lessor corporation, and is General Manager of the King Cotton Hotel for which he receives 47½% of the profits. Mr. Colvert devotes full time to the hotel as assistant or Resident Manager for which he receives 5% of the profits. Each of the aforementioned partners receive a monthly salary in addition to their share of profits.
Inasmuch as the control of the lease, which is vested in Mr. Ralph C. Price, controlling stockholder of the lessor corporation, is the sole income producing factor to the partnership, it is held herein that Mr. Price rather than his wife, Mrs. Martha Garner Price, is a partner.

* * * * *

No change was suggested by the report in partnership net income for any of the years covered.

(b) With respect to plaintiff, the revenue agent's report listed deficiencies for the years 1945, 1946, and 1947 in the amounts hereinafter shown[10] and stated:

* * * The principal cause of the additional tax is the findings set forth in RAR on King Cotton Hotel in which it is determined that the taxpayer is a partner in the King Cotton Hotel. * * *

(c) With respect to Mrs. Price, the revenue agent's report listed overassessments for the years 1945, 1946, and 1947 in the amounts hereinafter shown[11] and stated:

* * * The principal cause of the overassessment is the disallowance of the taxpayer in the King Cotton Hotel. * * *

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[10] Finding 24 (b).

[11] Finding 24 (b).

22. During May 1949, negotiations were completed for the transfer of the King Cotton Hotel (physical plant and hotel business) to the Alsonett hotel chain. Alsonett made offers to the members of the partnership and to the stockholders of Cotton States Hotel Company. The written offer to Mrs. Price of $100,000 for her interest in the partnership, which she accepted, was dated May 17, 1949. On May 9, 1949, at the instance of Alsonett and as part of the negotiations, the lease from Cotton States Hotel Company to the partnership was amended to eliminate the termination clause, increase the rent, and reduce the term. The sale was consummated on or about June 1, 1949.

After the sale to Alsonett, Mr. Duke remained with the King Cotton Hotel as manager.

Neither plaintiff nor Mrs. Price has since owned any interest in or been otherwise engaged in the hotel business.

The King Cotton Hotel partnership was formally dissolved on July 15, 1952.

23. On September 30, 1949, plaintiff gave to Mrs. Price his check in the sum of $78,758.88, and the note described in finding 19 was marked paid.

24. (a) On July 26, 1949, in a so-called 90-day letter, the Commissioner of Internal Revenue gave to plaintiff final notice of the determination of deficiencies in payments of income tax for the years 1945, 1946, and 1947.

(b) On September 30, 1949, the Commissioner of Internal Revenue timely assessed against plaintiff the following deficiencies in tax and interest thereon to August 15, 1949:

Taxable Period	Tax	Interest
1945	$48,267.18	$9,894.77
1946	60,531.35	8,777.05
1947	66,300.07	5,635.51
Total	175,098.60	24,307.33

These deficiencies were based upon taxing to plaintiff the income reported by Mrs. Price as received from the partnership King Cotton Hotel.

(c) The assessments were paid by plaintiff in the following manner:

(1) Plaintiff's check for $175,098.60 was mailed to the Collector of Internal Revenue on August 12, 1949. This sum was deposited by the Collector on or about August 15, 1949, in a suspense account and on October 6, 1949, was credited on the books of the Collector to the account of plaintiff as payment of the deficiency assement.

(2) On October 18, 1949, plaintiff paid to the Collector the sum of $24,307.33, covering the assessed interest.

25. On November 18, 1949, the Commissioner of Internal Revenue refunded to Mrs. Price the amounts of tax and of interest thereon for the taxable periods set forth below:

Year	Tax	Interest	Total
1945	$38,115.25	$8,315.02	$46,430.27
1946	45,592.88	7,216.79	52,809.67
1947	38,764.78	3,807.31	42,572.09
Totals	122,472.91	19,339.12	141,812.03

26. (a) On July 27, 1951, plaintiff filed claims for refund of the amounts that had been paid by him as deficiency assessments for the years 1945, 1946, and 1947.

(b) On May 16, 1952, pursuant to the provisions of section 3772 (a) (2) of the Internal Revenue Code of 1939, the Commissioner of Internal Revenue notified plaintiff by registered mail of the disallowance of these claims for refund.

27. (a) The petition in this case was filed on November 2, 1953.

(b) The third party complaint herein was filed on August 19, 1955.[12]

28. (a) Mr. Duke was the moving spirit in the formation of a partnership to operate the King Cotton Hotel under a lease from its corporate owner.[13] His primary objective, when the partnership was formed, was to eliminate the excess profits taxes for which it appeared the corporation might be liable.

(b) Interest in the partnership plan on the part of plaintiff and his father, Mr. Julian Price, was enlisted by Mr. Duke. All had the same interest in the elimination of excess profits taxes.

(c) On the basis of the tax consultant's advice that the corporation would probably be taxed for the partnership income if the partnership was composed of stockholders in the corporation and if the partners' shares were similar to their stock holdings, the problem was to introduce non-stockholders into the partnership, and to do so without diminishing the Price's ultimate, relative share of the profits. The selection of Mrs. Price was made for this purpose. Mr. Duke, plaintiff, and Mr. Julian Price agreed upon her selection, and Mrs. Price acquiesced in the plan.

(d) Plaintiff and his father were likewise aware at the time of possible further tax advantages for the Price family in the arrangement, in terms of income or gift

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[12] The third party complaint was filed pursuant to an understanding between counsel emanating from the preference expressed by counsel for plaintiff of handling the repayment of Mrs. Price's refunds in this way, if plaintiff is entitled to recover, rather than by stipulation.

[13] It must be inferred that the proposal made to the stockholders in June 1943 (finding 6 (b) was his project. At that time he owned no appreciable interest in the corporation. A partnership composed of himself and plaintiff would have given him the prospect of a larger share of the profits than his salary-plus-commission could provide.

taxes or both and in terms of their plans and objectives in respect to potential estate taxes.

(e) Mr. Duke, plaintiff, and Mr. Julian Price further agreed upon the selection of Mr. Colvert as the third partner. His selection served two purposes. One was the element of incentive to him, through a share in the profits. The other was to give the partnership a composition in which two members of the three were non-holders of stock in the owning corporation.

29. (a) Almost immediately after the partnership began operating the hotel, monthly payments were made by it to Mrs. Price in amounts indentical (during the first eight months) with (1) the salary payable to Mr. Duke and (2) the allowance she had theretofore received from plaintiff. Mrs. Price used this income, which she received in 1944, in much the same manner as she had previously used the allowance. There is nothing in the evidence to suggest that this arrangement for and disposition of income was the result of a plan that was conceived or formulated by plaintiff and his wife or either of them prior to the formation of the partnership.

(b) The uses made by Mrs. Price of her income from the partnership and other sources during the calendar years 1945, 1946, and 1947 are set forth in finding 14. The family purpose intended to be served by those uses, insofar as it was ever formulated or given expression as between the husband and wife, was to free his income for business uses. Neither of them was expressly conscious of the necessity for or the importance of an accounting between themselves until after the receipt of the letter from their tax adviser set forth in finding 18. That letter was part of the tax adviser's continuing effort to get his clients' records in the form deemed advisable by him for the purposes of potential estate taxes. The preparation of the list described in finding 18 and the execution and payment of the

note described in findings 19 and 23 were parts of the same pattern.

30. (a) The hotel operation was conducted by Mr. Duke, in whose judgment and ability the plaintiff, his father, Mrs. Price, and Mr. Colvert had implicit confidence. The determination to form a partnership was made as described in finding 28. Considering the favorable economic circumstances under which the partnership venture was launched and conducted, there was never any expectation or intention that any partner other than Mr. Duke would contribute substantially to the fundamental direction and management of the business venture.

(b) The plaintiff never intended to be a partner, and never participated in partnership affairs. He was interested, as described in finding 28, in setting up the venture as a means of providing income from the profits of the hotel operation for the family entity of himself and Mrs. Price. In this connection he acted to provide assurance through the termination clause in the lease against the possibility (however remote) of financial losses from the venture. Otherwise, he was content to leave the management in the hands of the partnership as constituted.[14]

(c) The considerations described in finding 28, plus agreement upon the division of profits between the partners (which was discussed at the meeting of Mr. Duke, plaintiff, and others, as described in finding 8), comprised the major preliminaries to the formation of the partnership. The uses made and to be made of Mrs. Price's income from the partnership were determined by consultation between plaintiff and Mrs. Price after the partnership was formed. Her use of such income in the payment of household and family expenses, thereby freeing his in-

[14] It is to be inferred from the evidence as a whole that Mrs. Price was a more active participant in partnership affairs than plaintiff would have been if he had undertaken it.

come for other uses, resulted from such consultations, and was not the result of a purpose consciously formed or expressed prior to the organization of the partnership.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover. Accordingly, plaintiff's petition and the third party complaint are dismissed.

INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	2
Argument	8
Conclusion	13

CITATIONS

Cases:	
Commissioner v. *Culbertson*, 337 U. S. 733	9, 11
Commissioner v. *Sunnen*, 333 U. S. 591	9, 10
Commissioner v. *Tower*, 327 U. S. 280	9
Helvering v. *Clifford*, 309 U. S. 331	10
Helvering v. *Horst*, 311 U. S. 112	9
Helvering v. *Stuart*, 317 U. S. 154, rehearing denied, 317 U. S. 602	10
Statute:	
Internal Revenue Code of 1939, Sec. 22 (a) (26 U. S. C. 1952 ed., Sec. 22 (a))	2, 9

In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 662

RALPH C. PRICE, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion, findings of fact, and conclusion of law of the Court of Claims (R. 3a–29a)[1] are reported at 142 F. Supp. 455.

JURISDICTION

The decision of the Court of Claims was entered on July 12, 1956. (R. 3a.) On August 8, 1956, taxpayer filed a motion for rehearing which was denied on October 2, 1956. The petition for a writ of certiorari was filed on December 28, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1255 (1).

[1] Record references herein are to the appendix to taxpayer's petition.

QUESTION PRESENTED

Was the Court of Claims warranted in concluding that the share of the profits of a partnership which taxpayer attributed to his wife was in substance and reality the income of taxpayer and taxable to him.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *
>
> (26 U. S. C. 1952 ed., Sec. 22.)

STATEMENT

The material facts, as found by the Court of Claims (R. 11a–29a), may be summarized as follows:

In 1943 taxpayer Ralph C. Price owned 51 of the 100 shares of the voting (common) stock of Cotton States Hotel Company, a corporation which owned and operated the King Cotton Hotel in Greensboro, North Carolina. (R. 12a–13a.) Taxpayer was also president of the corporation and received an annual salary of $2,500. (R. 15a.) The hotel, and thus the

corporation, enjoyed its most profitable year to date in 1943. Although the hotel's manager, Haywood Duke, held only one qualifying share in the corporation, he prospered with the hotel in 1943, receiving total compensation including a percentage of profits in excess of $21,000. (R. 13a.)

In June, 1943, a proposal was placed before the corporation's stockholders to lease the hotel to a partnership composed of taxpayer and Mr. Duke. The stockholders rejected the proposal. Thereafter, and prior to February 1, 1944, Mr. Duke purchased 47 shares of the common stock of the corporation. Taxpayer continued to hold 51 shares, and the two remaining shares were held by other individuals. (R. 13a–14a.)

Sometime after his stock purchase and before February 1, 1944, Mr. Duke sought the opinion of the corporation's auditor and tax consultant as to the feasibility of transferring the hotel operation from the corporation to a partnership, composed of the stockholders, in order to eliminate the payment of excess profits taxes by the corporation. The consultant advised that the device would be more likely to succeed if one member of the partnership was not a stockholder. Thereafter, the partnership proposal was discussed at a conference in which Mr. Duke participated with taxpayer, taxpayer's father, Julian Price, and an attorney. Mrs. Martha Garner Price, the taxpayer's wife, was not present at the meeting, but the proposal was later discussed with her by taxpayer, Mr. Julian Price and Mr. Duke. On February 1, 1944, a partnership agreement was signed by Mr.

Duke, Mrs. Price and Harold Colvert (the hotel's assistant manager). On the same date, the corporation leased the hotel to the partnership for a term of 20 years at a rental of $5,000 per month. (R. 14a–15a.)

Mr. Duke was the moving spirit in the formation of the partnership, but he succeeded in enlisting the interest of taxpayer and his father in the partnership plan. All had the same interest in the elimination of excess profits taxes. The problem was to introduce nonstockholders into the partnership without diminishing the Prices' ultimate, relative share of the profits. The selection of Mrs. Price was made for this purpose. Mr. Duke, taxpayer and taxpayer's father agreed upon her selection, and Mrs. Price acquiesced in the plan. Taxpayer and his father were likewise aware of possible further tax advantages for the Price family in the arrangement, in terms of income or gift taxes or both. (R. 26a–27a.)

The partnership agreement provided that the operating capital of the partnership should be $3,000, to be contributed by the partners as follows: Mr. Duke, $1,425, Mrs. Price, $1,425, Mr. Colvert, $150. The agreement further provided that the partnership profits should be divided as follows: 47½ percent to Mr. Duke, 47½ percent to Mrs. Price, and 5 percent to Mr. Colvert. Partnership losses were to be borne by the partners in the same proportions. Mr. Duke was named general manager of the business with a monthly salary of $500, and Mr. Colvert assistant manager with a monthly salary of $250. No duties were assigned to Mrs. Price. Matters of importance were to be approved by all partners. (R. 16a–17a.)

The lease of the hotel to the partnership contained the following clause (R. 15a):

> It is understood and agreed that inasmuch as the Lessees are not required to post a good and sufficient bond guaranteeing full performance on the part of said Lessees, the Lessor, at its option, may, with or without cause, and in its absolute discretion, terminate this lease at any time upon giving sixty (60) days' written notice to the Lessees.

The reason for the insertion of this clause is not explained by the evidence. Inferentially, it appears to have been devised for the protection of the Price interests, since Mrs. Price would have been more able than either of the other two partners to respond financially in the event of partnership liabilities exceeding its income and limited capital. (R. 15a.)

The partnership operation prospered from the beginning. Its federal information returns for the fiscal years ending January 31, 1945, 1946 and 1947, reported total net income and partners' shares (including salaries in the case of Mr. Duke and Mr. Colvert) as follows (R. 18a):

Partner	*1945*	*1946*	*1947*
Mr. Duke	$66,055.42	$83,532.14	$85,676.36
Mr. Colvert	9,446.62	11,161.27	11,386.99
Mrs. Price	60,055.42	77,532.44	79,676.36
Total	135,557.46	172,225.55	176,739.71

Prior to February 1, 1944, Mrs. Price received from taxpayer a monthly allowance of $500, which she deposited in her checking account and used to pay some of the household expenses. The remainder of the household and family expenses were paid by taxpayer.

After February 1, 1944, Mrs. Price's allowance was discontinued. From February through August of that year she received $500 a month from the partnership which she used in much the same manner as she had previously used her monthly allowance from taxpayer. From September through December, 1944, she received $1,000 a month from the partnership. On her returns for 1945, 1946 and 1947, she reported as partnership income (with one relatively minor variation) the shares attributed to her, as set forth above, in the partnership information returns. (R. 18a–19a, 27a.)

From March 1, 1944, until January 31, 1949, Mrs. Price paid household expenses amounting to $82,115.93. (R. 21a.) In 1946 she also disbursed $33,000 to the taxpayer, which he used to pay his 1945 income taxes. (R. 19a.) The family purpose intended to be served by these uses of partnership income, insofar as it was ever given expression as between husband and wife, was to free taxpayer's income for business uses. (R. 27a.)

Considering the favorable economic circumstances under which the partnership venture was launched and conducted, there was never any expectation or intention that any partner other than Mr. Duke would contribute substantially to the fundamental direction and management of the business venture. Taxpayer, his father, his wife, and Mr. Colvert had implicit confidence in the judgment and ability of Mr. Duke. (R. 28a.) He made all decisions except those concerning major expenditures. Mrs. Price and Mr. Colvert conferred with Mr. Duke, usually once or twice a

month, as to matters of importance, such as the purchase of elevators costing about $50,000 and a boiler costing about $30,000. (R. 18a) Mrs. Price also supported Mr. Duke's efforts to promote the hotel business in other ways. Her judgment and tastes were consulted and reflected in the selection of hotel furnishings and decorations; she was responsible for the custom of placing fresh flowers in the lobby and dining room; and she brought the hotel's facilities to the attention of the local chapter of the Junior League and other local groups. (R. 17a–18a.)

The partnership operated the hotel from February 1, 1944, until June 1, 1949, when the hotel business was sold to the Alsonett hotel chain. Alsonett paid Mrs. Price $100,000 for her interest in the partnership. (R. 17a, 24a.)

In December, 1948, an internal revenue agent began an audit of taxpayer's returns for 1945, 1946 and 1947, his wife's returns for the same years, and the partnership's returns for the fiscal years ending January 31, 1945, 1946 and 1947. In January, 1949, the agent recommended that taxpayer be taxed with the partnership income reported by Mrs. Price.

After this audit, the taxpayer and his wife examined her check stubs and listed her payments for household expenses and, on February 14, 1949, taxpayer gave her a note payable on demand for $76,539.24, bearing interest at 4½ percent. This note reflected the household expenses paid by Mrs. Price from March 1, 1944, through January 31, 1949, plus the amount advanced by her to pay taxpayer's 1945 income taxes and other items, less amounts paid to

her by taxpayer, characterized as repayments of loans. (R. 20a–22a.) On September 30, 1949, taxpayer paid this note with interest. (R. 24a.)

Meanwhile, on July 26, 1949, the Commissioner gave taxpayer final notice of the determination of deficiencies for 1945, 1946 and 1947. These deficiencies with interest were assessed against taxpayer on September 30, 1949, and were paid by taxpayer. On November 18, 1949, the Commissioner made refunds to Mrs. Price, reflecting adjustment of her 1945, 1946 and 1947 returns to exclude income from the partnership. (R. 24a–25a.)

ARGUMENT

The issue here presented is essentially factual in nature, not warranting review by the Court. Moreover, the decision below is not in conflict with any other appellate decision.

1. Taxpayer attacks here the ruling of the Court of Claims that certain income from the operations of a hotel by the King Cotton Hotel partnership was taxable to him rather than to his wife. Taxpayer bases this attack in part upon the contention (Pet. 8–11) that the Court of Claims did not decide the question before it in its proper legal context. In so contending taxpayer misconceives both the nature of the question presented and the manner of its disposition. There is no dispute that the parties created a valid partnership in 1944; that the manager and assistant manager of the hotel were valid partners; and that the partnership income was correctly reported in its information returns for the relevant tax years. (R. 22a–23a.) The only question is whether taxpay-

er's wife was a nominal partner whose share of partnership income was, in substance and in legal effect, realized by and taxable to her husband. The legal criteria governing the determination of this factual question are not restricted, as taxpayer contends (Pet. 8–11, 19, 21–22), to a special set of principles applicable only to partnership situations. In every case where it is necessary to determine which party of several must be taxed with certain income, the general principles established by this Court with respect to realization of "income" under Section 22 (a) of the 1939 Code, *supra*, p. 2, come into play. Indeed, these general principles have been freely invoked and applied by this Court in partnership situations, for although income be derived from a partnership, it is still "income" within the meaning of Section 22 (a). *Commissioner* v. *Culbertson*, 337 U. S. 733, 740; *Commissioner* v. *Tower*, 327 U. S. 280.

It is well settled that so long as a taxpayer controls income-producing property, or controls the receipt of income therefrom, he cannot escape tax liability for such income by causing it to be received by someone else. *Commissioner* v. *Sunnen*, 333 U. S. 591; *Helvering* v. *Horst*, 311 U. S. 112.

As this Court held in *Commissioner* v. *Tower*, 327 U. S. 280, 290: "It is the command of the taxpayer over the income which is the concern of the tax laws. *Harrison* v. *Schaffner*, 312 U. S. 579, 581, 582." And in each case the test whether such command or control has been retained depends upon the end result and not upon any isolated step or steps in a series of related transactions. *Commissioner* v. *Tower*, *supra*, p. 290;

Helvering v. *Stuart,* 317 U. S. 154, rehearing denied, 317 U. S. 602; *Helvering* v. *Clifford,* 309 U. S. 331. To be taxable on the basis of his retention of control over the income-producing property or over receipt of the income therefrom, it is necessary only that the taxpayer have the right to exercise such control and not that he have actually exercised that right. *Commissioner* v. *Sunnen, supra*; *Helvering* v. *Stuart, supra,* pp. 170–171.

These principles have special applicability to all intra-family transactions. This Court said in *Commissioner* v. *Sunnen, supra,* p. 605:

> It is in the realm of intra-family assignments and transfers that the *Clifford-Horst* line of cases has peculiar applicability. While specifically relating to short-term family trusts, the *Clifford* case makes clear that where the parties to a transfer are members of the same family group, special scrutiny is necessary "lest what is in reality but one economic unit be multiplied into two or more by devices which, though valid under state law, are not conclusive so far as section 22 (a) is concerned." 309 U. S. at 335. That decision * * * also recognizes that the fact that the parties are intimately related, causing the income to remain within the family group, may make the transfer give rise to informal and indirect benefits to the transferor so as to make it even more clear that it is just to tax him.

In short, a device which may be valid under state law to multiply economic units within a family—whatever form it may take, including the use of trusts and

partnerships—will not be recognized for federal tax purposes if the husband retains command of the income in question. And the need for special scrutiny in such cases is further illuminated by *Commissioner* v. *Culbertson, supra,* where this Court said that (p. 746)—

> the family relationship often makes it possible for one to shift tax incidence by surface changes of ownership without disturbing in the least his dominion and control over the subject of the gift or the purposes for which the income from the property is used. He is able, in other words, to retain "the substance of full enjoyment of all the rights which previously he had in the property." *Helvering* v. *Clifford, supra,* at 336.

In the case at bar the Commissioner determined that the taxpayer retained control over the income-producing property and over the receipt of the income therefrom; that the purported status of taxpayer's wife as a partner was, for tax purposes, a sham which should be disregarded; and that the share of the partnership income which taxpayer seeks to attribute to her should be taxed to taxpayer as the true beneficial owner of her alleged partnership interest. (R. 21a–24a.) The Court of Claims sustained this determination, ruling that (R. 10a) "the transaction insofar as plaintiff was concerned lacked substance and was a tax sham." We submit that this ruling is amply warranted by the facts of record, in the light of the controlling decisions of this Court.

Moreover, in terms specifically applicable to partnerships, taxpayer rather than his wife was the true contributor to the capital of the partnership. The initial capital of the partnership ($3,000 cash) was nominal; the real asset of value with which the partnership commenced business was the leasehold, which brought net income to the partnership totalling more than $484,000 in the three tax years 1945–1947. (R. 18a.) As we have demonstrated, taxpayer controlled the income-producing property by virtue of his majority stockholdings and (without reference to his retention of that control through the termination clause of the lease) he was surely the true contributor to the capital of the partnership, rather than his wife, when he caused the corporation to execute the lease.

As for services to the partnership, we believe it is quite obvious from the findings summarized in the statement that the services of taxpayer's wife were as nominal as her contribution to partnership capital. From every point of view, taxpayer, then, was the true beneficial owner of her purported partnership interest. And the share of partnership income received by her was, in substance and in legal effect, realized by taxpayer and is taxable to him.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

J. LEE RANKLIN,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
ROBERT N. ANDERSON,
GRANT W. WIPRUD,
Attorneys.

JANUARY 1957.

U. S. GOVERNMENT PRINTING OFFICE: 1957

FILED
JAN 28 1957
JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 662

RALPH C. PRICE, *Petitioner*

v.

THE UNITED STATES

On Petition for a Writ of Certiorari to the United States Court of Claims

PETITIONER'S REPLY TO BRIEF IN OPPOSITION

STANLEY WORTH
EDWARD S. SMITH
404 Transportation Building
Washington 6, D. C.

D. NEWTON FARNELL, JR.
Jefferson Standard Building
Greensboro, North Carolina
Counsel for Petitioner

Of Counsel:
BLAIR, KORNER, DOYLE & WORTH

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	1
STATUTE INVOLVED	3
STATEMENT	3
ARGUMENT	5
CONCLUSION	9

CITATIONS

CASES:

Culbertson, Commissioner v., 337 U.S. 733 .....5, 6, 7, 8
Lusthaus v. *Commissioner*, 327 U.S. 293 6
Lynch v. *Commissioner*, 216 F. 2d 574 (CA-7, 1954) 6
Pike, Thomas P. v. *U. S.*, 231 F. 2d 688 (CA-9, 1956) 6
Scofield v. *Blackburn*, 217 F. 2d 557 (CA-5, 1954) .. 6
Scofield v. *Davant*, 218 F. 2d 486 (CA-5, 1955) 6
Snyder v. *Westover*, 217 F. 2d 928 (CA-9, 1954) .. 6
Tower, Commissioner v., 327 U.S. 280 6

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PETITIONER'S REPLY TO BRIEF IN OPPOSITION

The Brief for the United States in Opposition to the Petition for Writ of Certiorari unjustifiably seeks to minimize both the number of questions presented for review by this Court, and the importance thereof. For that reason, this reply is deemed necessary.

QUESTION PRESENTED

Without directly challenging petitioner's statement of Questions Presented (Pet. 2-3), the respondent

seeks to limit the questions presented for review to one, namely (Bf. Op. 2):

> Was the Court of Claims warranted in concluding that *the share of the profits of a partnership which taxpayer attributed to his wife* was in substance and reality the income of taxpayer and taxable to him. (Emphasis supplied)

The italicized portion of respondent's statement is equivocal and misleading. It suggests that the petitioning taxpayer was the real partner, and that he permitted his wife to draw his share of partnership income. Yet the Court below specifically found that this taxpayer "never intended to be a partner, and never participated in partnership affairs."[1]

The respondent would exclude from consideration by this Court the following questions (among others) which are inherent in the petitioner's statement of Questions Presented:

1. In a valid partnership can a person, who never intended to be a partner and who never participated in partnership affairs nor received any partnership income, be taxed as if he were a partner?

2. Absent a specific finding that the petitioner was a partner and that his wife was not, is the decision below sustainable, particularly in light of the actual findings which meet every test to the contrary?

3. Once the existence of a valid partnership is established, is there any occasion to look beyond the partnership provisions of the Internal Revenue Code[2] to determine the taxability of partnership income?

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[1] Fdg. 30(b). App. 28a.

[2] §§ 181-183 (26 U.S.C.A. 1944 edition).

STATUTE INVOLVED

The Brief in Opposition refers only to Section 22 of the Internal Revenue Code. The omission of Sections 181-183 of the Internal Revenue Code of 1939 (26 USCA—1944 edition) evidences the respondent's unwillingness to recognize that those omitted sections, dealing expressly with taxation of partnership income, have any application, notwithstanding the sole issue is concerned with that subject. As will be seen, *infra,* under Argument, the omission of reference to the partnership provisions of the law was not inadvertent.

STATEMENT

In the respondent's summary of the material facts found by the Court of Claims, there are significant omissions which the petitioner desires to point out.

At the bottom of page 4 of the Brief in Opposition it is stated that "Matters of importance were to be approved by all partners. (R. 16a-17a.)" That is what the partnership agreement provided. But the Court of Claims made a further pertinent finding which appears as the last paragraph in Finding 12 (App. 18a) as follows:

> While the partners did not meet regularly or on any fixed schedule, they did assemble once or twice a month, and the provision in their agreement that "all matters of importance shall be approved by all of the partners" was fully observed.

On page 6 of the Brief in Opposition there is reference to household expenses paid by Mrs. Price and to loans by her to the petitioner. These items as well as offsetting items are summarized in Finding 18

(App. 21a-22a). The respondent does not mention Finding 19 (App. 22a) which finds that the petitioner gave his note to cover the net amount, plus interest, nor to Finding 23 (App. 24a) with respect to the payment of that note, together with interest.

In the same paragraph the respondent, citing R. 27a, states a somewhat abridged version of a portion of Finding 29(b). Had the respondent continued further with that finding, it would be disclosed that neither the petitioner nor his wife "was expressly conscious of the necessity for nor the importance of an accounting between themselves until after the receipt of the letter from their tax advisor set forth in Finding 18."

And if the respondent had gone still further into the Court's findings, the following statement from Finding 30(c) (App. 28a-29a) would have been disclosed:

> The uses made and to be made of Mrs. Price's income from the partnership were determined by consultation between plaintiff and Mrs. Price after the partnership was formed. Her use of such income in the payment of household and family expenses, thereby freeing his income for other uses, resulted from such consultations, and was not the result of a purpose consciously formed or expressed prior to the organization of the partnership.

And on the all-important matter of whether the petitioner was or intended to be a partner the respondent omitted reference to Finding 30(b) (App. 28a), the first sentence of which reads: "The plaintiff never intended to be a partner, and never participated in partnership affairs." In fact,

the Court below held further—in footnote 14 (App. 28a). It stated: "It is to be inferred from the evidence as a whole that Mrs. Price was a more active participant in partnership affairs than plaintiff would have been if he had undertaken it."

ARGUMENT

In the Brief in Opposition, the first sentence in the Argument is "The issue here presented is essentially factual in nature, not warranting review by the Court." Even if the Government were correct in stating that the issue is factual, we might at least expect to find that the decison is supported by the lower Court's findings of fact. But when we examine the findings of fact it is at once apparent that under every test laid down by this Court in *Commissioner* v. *Culbertson,* 337 U.S. 733, the petitioning taxpayer's wife was a partner, and the taxpayer was not a partner, and never intended to be a partner. The Court of Claims specifically found that the taxpayer "never intended to be a partner and never participated in partnership affairs." (Fdg. 30(b), App. 28a). And in Footnote 14 to the same finding (App. 28a) the lower Court went further in stating "It is to be inferred from the evidence as a whole that Mrs. Price was a more active participant in partnership affairs than plaintiff would have been if he had undertaken it."

The Court of Claims made no specific finding, as an ultimate finding, either that the taxpayer was a partner, or that his wife was not a partner. Absent a specific finding that the taxpayer was a partner, the decision of the Court below that the Commissioner properly taxed to him his wife's partnership share,

is without support. And any such ultimate finding would be inconsistent with its evidentiary findings.

Reason II in the Petition for Writ of Certiorari (page 12) is based upon conflict between the findings and the decision by the Court below. The respondent has not seen fit to answer this contention in the Brief in Opposition.

The second sentence in the respondent's Argument reads: "Moreover, the decision below is not in conflict with any other appellate decision." The first reason stated in the Petition for Writ of Certiorari (page 8) is that the decision below is in direct conflict with the established law relating to taxation of partnership income under the principles laid down by this Court in *Commissioner* v. *Culbertson*, 337 U.S. 733, which amplified and clarified *Commissioner* v. *Tower*, 327 U.S. 280, and *Lusthaus* v. *Commissioner*, 327 U.S. 293. The respondent cannot, and does not, answer this contention. Instead, the Brief in Opposition sidesteps it and asserts that there is no conflict "with any other appellate decision". But even that statement is too sweeping. It ignores circuit court decisions which have recognized the *Culbertson* principles as the law of the land.[3] The decision below is in conflict with those decisions just as it is in conflict with *Commissioner* v. *Culbertson, supra.*

The Brief in Opposition, near the bottom of page 8, admits "There is no dispute that the parties created a valid partnership in 1944;". Neither did the Court

[3] *Scofield* v. *Blackburn*, 217 F. 2d 557 (CA-5, 1954).
Snyder v. *Westover*, 217 F. 2d 928 (CA-9, 1954).
Thomas P. Pike v. *U. S.*, 231 F. 2d 688 (CA-9, 1956).
Lynch v. *Commissioner*, 216 F. 2d 574 (CA-7, 1954).
Scofield v. *Davant*, 218 F. 2d 486 (CA-5, 1955).

of Claims deny the validity of the partnership. Both the Court below and the respondent in its Brief in Opposition freely refer to the "partnership", and to Mrs. Price as a "partner". Without more, the provisions of the Internal Revenue Code dealing with the taxation of partnership income, namely, §§ 181-183 (26 U.S.C.A. — 1944 edition), are not only applicable, but are controlling. The Brief in Opposition does not even refer to these partnership provisions of the Code either under "Statute Involved" (page 2) or in the argument (pages 8-12). Instead, it relies exclusively on Section 22(a) of the Code. Yet, in the majority opinion, in *Commissioner* v. *Culbertson,* 337 U.S. 733, 739-740, this Court refers to Section 181 and states:

> To hold that "Individuals carrying on business in partnership" includes persons who contribute nothing during the tax period would violate the first principle of income taxation: that income must be taxed to him who earns it.

The concurring opinion by Mr. Justice Frankfurter in the *Culbertson* case made crystal clear the distinction between the taxability of partnership income under Sections 181 and 182 of the Code and the taxability of income under the broad economic concept of Section 22(a). This distinction has been overlooked by the respondent who pitches its argument solely under Section 22(a). As stated by Mr. Justice Frankfurter (337 U.S. at pp. 750-751):

> The taxability of income under §§ 181 and 182 is not a purely economic problem like the determination under § 22 (a), 26 USCA 1948 ed § 22 (a), 6 FCA title 26, § 22 (a), of what is income and to whom it is attributable. The word

> "income" has none but an economic significance, and so the application of § 22 (a) is properly a matter of economic analysis. Cf. Lucas v. Earl, 281 US 111, 74 L ed 731, 50 S Ct 241. But §§ 181 and 182 import a concept of a different sort. These sections make taxability turn on the existence of the relation of "partnership".

This Court will not fail to note the conflict between the decision below and the clear cut principles of the *Culbertson* case. Nor will it overlook the respondent's failure to challenge the other valid reasons in the Petition for Writ of Certiorari which justify the exercise of its power of supervision over the decision below.

The only other point of argument in the Brief in Opposition which merits a reply appears on page 12. There it is asserted that the real asset of value to the partnership was the leasehold. The respondent would have this Court believe that this lease of the hotel, in and of itself, produced the partnership income; that neither the abilities nor the activities of the partners in conducting the operations of the hotel were of any importance, even though the partnership net income far exceeded the corporate net income prior to the lease; and that the petitioning taxpayer, as the owner of 51% of the voting common stock of the corporation, caused the corporation to execute the lease to the partnership, and thereby "he was surely the true contributor to the capital of the partnership". If that was the basis for the decision of the Court of Claims, and if that decision should stand, we might as well discard the provisions of the Code dealing with the taxation of partnership income, and the *Culbertson* case as well.

CONCLUSION

The respondent has failed to state any valid reason for this Court's denial of the Petition for Writ of Certiorari and, accordingly, the Petition should be granted for the reasons set forth therein.

Respectfully submitted,

STANLEY WORTH
EDWARD S. SMITH
404 Transportation Building
Washington 6, D. C.

D. NEWTON FARNELL, JR.
Jefferson Standard Building
Greensboro, North Carolina
Counsel for Petitioner

Of Counsel:

BLAIR, KORNER, DOYLE & WORTH